CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
CORE INDUSTRIAL REAL ESTATE

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous core industrial real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Core Industrial Real Estate Portfolio ("the Portfolio"). The design of this Policy ensures that investors, managers, partners, members, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Portfolio.

II. STRATEGIC OBJECTIVE

Achieving the highest risk-adjusted total rate of return possible is the strategic objective of the Portfolio. This objective shall reflect prudent levels of risk, the liabilities of the System, and the investment guidelines contained herein.

The Core Industrial Real Estate Portfolio shall be managed to accomplish the following:

A. Provide diversification;

B. Preserve investment capital;

C. Generate attractive risk-adjusted rates of return for the System;

D. Provide a hedge against inflation;

E. Provide stable cash flow from operations;

F. Provide appreciation potential; and

G. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVES

A. Exceed (after fees) a minimum target real rate of return of 5.0%; and

B. Exceed (before fees) the National Council of Real Estate Investment Fiduciaries Index ("the NCREIF Index") while maintaining an appropriate level of diversification to mitigate risk.

IV. ASSET ALLOCATION

Subject to the Statement of Investment Policy for Equity Real Estate, the following is the current asset allocation range for the Core Industrial Real Estate Portfolio as a percent of the total Equity Real Estate Portfolio:

	Range
Core Industrial Real Estate Portfolio:	10-35%

From time to time, the actual allocations may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments to correct the actual allocations to comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the System's investment returns, is considered a reasonable time frame.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Diversification

The Portfolio shall reduce risk through appropriate diversification. Diversification shall occur primarily by geography and investment strategy, as outlined below.

1. Diversification by Geography

The Portfolio shall be comprised primarily of investments in the United States. The Portfolio shall contribute to the overall geographic diversification objectives of the Core Real Estate Portfolio as specified in the Statement of Investment Policy for Equity Real Estate.

2. Diversification by Strategy

The System shall employ a broad range of strategies for industrial property investments. The allocation ranges established for each of the recommended strategies are a percentage of the Core Industrial Real Estate Portfolio listed below. To mitigate risk, the System shall place less emphasis on strategies carrying a greater degree of uncertainty.

Strategy	Allocation Range
Existing Warehouse	10-100%
Existing Flex Space	0 - 35%
Existing R&D	0 - 20%
Existing Office Showroom	0 - 10%
Build-to-Suit Development	0 - 15%
Speculative Development	0 - 10%
Land	0 - 5%

The Senior Investment Officer of Real Estate may allow a specific core property sector to exceed the 10% Speculative Development level as long as the **overall** Core Portfolio Speculative Development level **does not** exceed 10%.

3. From time to time, the actual allocations of various geographic sectors and investment strategies may fall out of the ranges prescribed by the Policy. In these instances, the System shall implement adjustments correcting the actual allocations so they comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving investment returns for the System, is considered a reasonable time frame.

B. Investment Objectives and Criteria

1. Existing Warehouse Properties

a. “Warehouse” shall refer to buildings containing at least 50,000 square feet or greater, with a maximum of 15% office space, and the balance having an 18-foot or greater ceiling height. All loading is dock height.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 80% occupancy upon acquisition;

(2) High quality construction with preferably concrete tilt-up or block;

(3) A full range of good-quality amenities, preferably having 22-foot or greater ceiling heights, appropriate ratio of dock doors and bay depths, minimum 110 feet truck-turning area, and fully sprinklered;

(4) Locations will feature proximity to major modes of transportation, including freeways, railways, and airports;

(5) Each property shall produce a minimum five-year real IRR (after fees) of 5%;

(6) Each property shall produce an appropriate risk-adjusted return; and

(7) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

2. Existing Flex Space Properties

a. “Flex Space” shall refer to single story buildings having 10 to 18-foot ceiling heights, with both floor height and dock height loading. Office build-out is typically greater than 15%.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 80% occupancy upon acquisition;

(2) Construction and amenities shall be competitive with the high end of the sub-market. Amenities to include 12 to 18-foot

ceiling heights, appropriate parking ratios, and fully sprinklered;

(3) Locations will feature proximity to major industrial parks and distribution centers;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 5.75%;

(5) Each property shall produce an appropriate risk-adjusted return; and

(6) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

3. Existing Research and Development ("R&D") Properties

a. R&D shall refer to one and two story buildings having 10 to 15-foot ceiling heights, with up to 50% office/dry lab build-out (remainder in wet lab, workshop, storage, and other support), with dock height and floor height loading;

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 85% occupancy upon acquisition;

(2) Construction and amenities shall be competitive with the high end of the sub-market. Amenities include 14 to 20-feet ceiling heights, appropriate parking ratios, and fully sprinklered;

(3) Locations will feature in select major R&D markets able to support high tech businesses;

(4) Each property shall produce a minimum five-year real IRR (after fees) that exceeds 6.00%;

(5) Each property shall produce an appropriate risk-adjusted return; and

(6) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

4. Existing Office Showroom Properties

a. “Office showroom” shall refer to single story (or mezzanine) buildings having 10 to 16-foot ceiling heights with frontage treatment on one side and dock height loading or grade level roll-up on the other. Office build-out is typically less than 15%.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 80% occupancy upon acquisition;

(2) High quality construction with preferably concrete tilt-up or block;

(3) A full range of good quality amenities, preferably having 14-foot or greater ceiling heights, good truck access, appropriate parking ratios, and fully sprinklered;

(4) Locations will feature proximity to major industrial parks and distribution centers;

(5) Each property shall produce a minimum five-year real IRR (after fees) of 5.50%;

(6) Each property shall produce an appropriate risk-adjusted return; and

(7) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

5. Build-to-Suit Development

a. “Build-to-suit” shall refer to a to-be-built industrial property developed for, and leased to, a single tenant with a minimum lease term of five years.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 75% pre-leased occupancy. Developer may have earn-out hurdles tied to lease-up, as appropriate;

(2) Amenities shall be competitive within sub-market;

(3) Locations shall be selected from major regional distribution markets;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 5.25%;

(5) Each property shall produce an appropriate risk-adjusted return; and

(6) Additionally, development projects shall require an acceptable initial stabilized cash return.

d. Additional Criteria

(1) Development is subject to guidelines set forth in the Statement of Investment Policy for Development Investments and the Statement of Investment Policy for Equity Real Estate Joint Ventures;

(2) Development activities shall focus on strategic partnerships with quality developers; and

(3) The investment manager shall control design, amenities, costs and overall quality of construction projects.

6. Speculative Development

a. “Speculative development” shall refer to the construction of buildings, primarily warehouse, leased to one or more tenants with minimal or no pre-leasing.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) No minimum occupancy. Developer may have earn-out hurdles tied to lease-up, as appropriate;

(2) Amenities shall be competitive within sub-market;

(3) Locations shall be selected from major regional distribution markets;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 6.5%;

(5) Each property shall produce an appropriate risk-adjusted return; and

(6) Additionally, new development projects shall require an acceptable initial stabilized cash return.

d. Additional Criteria

(1) Development is subject to guidelines set forth in the Statement of Investment Policy for Development Investments and the Statement of Investment Policy for Equity Real Estate Joint Ventures;

(2) Development activities shall focus on strategic partnerships with quality developers; and

(3) The investment manager shall control design, amenities, costs and overall quality of construction projects.

7. Land

a. “Land” shall refer to undeveloped, vacant land intended for development of industrial buildings.

b. Investment objective is to acquire land intended for development of industrial properties.

c. Investment Criteria

(1) Location shall be selected from supply constrained markets, strategic in-fill locations, and within the sub-markets of existing assets to accommodate growth;

(2) Minimum five-acre parcel size;

(3) Entitlements are defined as land acquisitions that meet the following criteria:

(a) Zoned for industrial development;

(b) Free of governmental restrictions to industrial development (including, but not limited to no-growth initiatives, building moratoriums, and conflicts with general plan amendments); and

(c) Reasonable expectations for receiving site plan approval in the ordinary course of business;

(4) Environmental compliance is met when a satisfactory Phase I environmental report is completed prior to land acquisition;

(5) Each property shall produce a minimum five-year real IRR (after fees) of 7.5%; and

(6) Each property shall produce an appropriate risk-adjusted return.

VI. GENERAL

Unless otherwise noted, investors, managers, consultants, partner members or other participants selected by the System shall base all calculations and computations on Fair Market Value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation for accounting purposes. See Statement of Investment Policy for Equity Real Estate Appraisal and Valuation Policy.

VII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms is referenced in the System's Master Glossary of Terms.